

**IT 05-9**

**Tax Type: Income Tax**

**Issue: Responsible Corporate Officer – Failure to File or Pay Tax**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE &  
JOE BLOW, as Responsible  
officers of ABC Inc.,  
Taxpayer**

**No. 04-IT-0000  
FEIN: 00-0000000  
Period 2/Q/02 – 3/Q/03**

**Ted Sherrod  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Special Assistant Attorney General Ralph Bassett on behalf of the Illinois Department of Revenue; Alan F. Segal of Alan F. Segal & Associates on behalf of John Doe.

**Synopsis:**

This matter comes on for hearing pursuant to John Doe's (hereinafter "Doe" or "taxpayer") protest of Notice of Deficiency number 0000 (hereinafter the "NOD") as responsible officer of ABC Inc. (hereinafter "ABC"). The NOD represents a penalty liability for withholding taxes for the second, third and fourth quarters of 2002 and the first, second and third quarters of 2003. Joe Blow, a named party in this matter, withdrew his protest and request for hearing on March 1, 2005 and did not participate in these proceedings. A hearing was held in this matter on August 3, 2005 with Doe providing oral testimony. By agreement of the parties, and pursuant to a motion in limine

filed by the Department and granted by the administrative law judge, the taxpayer was precluded from introducing any documentary evidence into the record in these proceedings.<sup>1</sup> Following the submission of evidence and memoranda of law, and a review of the record, it is recommended that NOD number 0000 at issue in this case be finalized as issued. In support of this recommendation, the following "Findings of Fact" and "Conclusions of Law" are made.

**Findings of Fact:**

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of Notice of Deficiency number 0000 showing a penalty liability for John Doe in the amount of \$45,697.15 for the period 2/Q/02 through 3/Q/03. Department ("Dept.") Group Exhibit ("Ex.") No. 1.
2. ABC Inc. ("ABC") was an Illinois corporation located in Anywhere, Illinois (Dept. Group Ex. 1 (Notice of Deficiency, Payroll Tax Returns)), and was engaged in the business of imprinting and selling shirts and other apparel (Transcript ("Tr.") pp. 20, 21, 23, 63), and acting as a manufacturers' representative responsible for the distribution of manufacturers' products to sporting goods stores around the country and answering inquiries from the manufacturers' customers. Tr. pp. 16, 23.
3. John Doe was the President of ABC and was in charge of the company's operations, and new business development. Tr. pp. 22, 23, 38. He was also responsible for the

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<sup>1</sup>On April 27, 2005, the Administrative Law Judge ("ALJ") entered an order requiring the parties to exchange all documents to be submitted at the hearing at least 14 days prior to the hearing date. The taxpayer failed to present any documents to the Department prior to the hearing, and the Department filed a motion in limine to bar the presentation of any documents by the taxpayer at the hearing based upon this failure to produce. The taxpayer admitted that he had no excuse for failing to produce documents as required by the ALJ's order, and agreed that the Department's motion in limine should be granted. Tr. pp. 5-7.

development of software for use in the company's operations. Tr. pp. 43, 44, 46. Prior to joining ABC, Doe managed business operations for XYZ, a family owned business started by his father prior to 1978, which was engaged in imprinting and selling shirts and acting as a manufacturers' representative and distributor for Russell Athletics in ten states. Tr. pp. 16-20. As XYZ's manager of operations, Doe supervised the company's apparel distribution and related operations and developed specialized expertise in this area. Tr. pp. 16, 17, 22, 63. Doe's brother and father handled XYZ's financial affairs, including accounting and tax preparation. Tr. pp. 18, 71.

4. Doe's background in business and accounting included training at the University of Wyoming where he studied accounting and finance for three years. Tr. pp. 41-43. Doe did not complete a degree program in either of these fields. Tr. p. 71.
5. Joe Blow ("Blow") was a principal owner and Chief Executive Officer of ABC. Tr. pp. 12, 20, 21, 27, 28; Dept. Group Ex. 1 (Illinois Business Registration). Prior to becoming Chief Executive Officer of ABC, Blow was Chief Executive Officer of Holdings, a company engaged in apparel printing and design. Tr. p. 21. Blow had a background in investment banking and used his expertise in this area to arrange financing for ABC. Tr. pp. 21, 28, 29, 47, 58, 59.
6. Blow was primarily responsible for the preparation and filing of ABC's tax returns. Tr. pp. 24-27, 39; Dept. Group Ex. 1 (Payroll Tax Returns, Illinois Business Registration).<sup>2</sup>

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<sup>2</sup> Blow signed section 14 of the Illinois Business Registration ABC filed on August 1, 2001. This section provides as follows: "*I accept responsibility for filing of returns and the payment of taxes due.*"

7. On August 1, 2001, XYZ merged into ABC, transferred all of its assets to this company and ceased to exist as a separate entity. Tr. p. 22; Dept. Group Ex. 1 (Illinois Business Registration). Doe became an employee of ABC pursuant to an employment agreement Blow offered him, and was given the title of President pursuant to this agreement. Tr. pp. 22, 23. Doe continued to serve as ABC's President throughout the tax period in controversy. Tr. pp. 10, 47, 48; Dept. Group Ex. 1 (Illinois Business Registration).
8. Pursuant to the terms of the aforementioned employment agreement, Doe was to receive an amount of ABC stock equivalent to the amount of stock in the company owned by Blow. Tr. pp. 22, 46. However, no stock was ever issued to Doe pursuant to this agreement, and Doe never became a stockholder in ABC. Tr. pp. 47, 48, 57-59.
9. As President of ABC, Doe had the power to hire and fire company personnel. Tr. p. 37. However, Doe never exercised this authority to fire personnel working in sales, finance or accounting. Tr. pp. 37, 38.
10. ABC had intermittent cash flow problems throughout the tax period in controversy. Tr. p. 54. Blow secured an equity investment in ABC from Investments, an investment banking company located in Some State, to address this concern. Tr. pp. 28-30, 39. Doe was fully aware of the company's cash flow difficulties. Tr. pp. 29, 30.
11. As a result of its cash flow problems, ABC could not always pay its vendors or meet its payroll. Tr. pp. 49-54. Doe, who was the company's primary contact with

vendors, and was responsible for distributing payroll checks to employees, was aware of these problems. *Id.*; Tr. p. 69.

**12.** Doe was aware of the company's tax problems, and that the Internal Revenue Service ("IRS") was investigating ABC for failure to pay withholding taxes, and met with an IRS agent to discuss this matter. Tr. pp. 56, 57, 70, 71. Doe was aware of ABC's delinquent payroll taxes prior to this meeting. Tr. p. 71.

**13.** Doe was an authorized signatory on ABC's bank account. Tr. p. 65.

**14.** Doe had complete access to ABC's books and records prepared during the tax period in controversy. Tr. pp. 59-62.

**15.** ABC ceased doing business prior to May, 2004, when Blow shut down the company and moved its assets and employees into a new corporation. Tr. pp. 13, 15. Doe had no involvement in this new corporation. Tr. p. 13.

### **Conclusions of Law:**

The issue in this case is whether John Doe was a responsible person who willfully failed to collect, truthfully account for and pay over withholding tax for ABC Inc. as required by statute, and is, therefore, personally liable for the penalty imposed by Section 1002(d) of the Illinois Income Tax Act, 35 ILCS 5/1002(d). Section 1002(d) provides that a penalty may be imposed by section 3-7 of the Uniform Penalty and Interest Act ("UPIA") which, in turn, provides as follows:

- (a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully (*sic*) fails to file the return or make the payment to the Department or wilfully (*sic*) attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest

and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section.  
35 ILCS 735/3-7(a)

To impose personal liability for failure to pay withholding taxes, it must be shown that the person is a responsible party and that the failure to pay was willful. Section 904(a) of the Illinois Income Tax Act, 35 ILCS 5/904(a), provides that the Department's *prima facie* case is established by the admission into evidence of the Department's determination of the correct amount of tax due. Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1<sup>st</sup> Dist. 1981). By introducing the Notice of Deficiency at issue into evidence, under the certificate of the Director, the Department established its *prima facie* case against the taxpayer. 35 ILCS 5/904(a); 35 ILCS 5/914; Balla, *supra*.

Pursuant to Section 3-7(a) of the UPIA (35 ILCS 735/3-7(a)) noted above, an officer or employee of a corporation may be held personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing returns and paying the taxes, and (2) the individual willfully failed to perform these duties. For guidance in determining whether a person is responsible under Illinois law, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (26 U.S.C.A. § 6672).<sup>3</sup> See Branson v. Department of Revenue, 168 Ill. 2d 247, 254-56 (1995); Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is

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<sup>3</sup> Internal Revenue Code section 6672 (26 U.S.C.A. §6672) imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

whether the person had significant control over the corporation's finances. See also Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1188 (7<sup>th</sup> Cir. 1987). Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F. 2d 1210, 1214-1215 (7<sup>th</sup> Cir. 1970), cert. den. 400 U.S. 821 (1970).

In addition, these cases define "willful" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson, *supra* at 254-56; Heartland, *supra* at 29-30. Willful conduct does not require bad purpose or intent to defraud the government. Branson, *supra* at 255; Heartland, *supra* at 30. Rather, willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F. 2d 425, 427 (7<sup>th</sup> Cir. 1987). Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland, *supra* at 30; Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill. 2d 568, 577 (1977).

Under section 904(a) of the Illinois Income Tax Act, 35 ILCS 5/904(a), the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due. See also Branson, *supra* at 260. Once the Department presents its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not a responsible corporate officer or employee, or that the person's actions were

willful. *Id.* at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. Jefferson Ice Co. v. Johnson, 139 Ill. App. 3d 626, 633 (1985); Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1991); A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1<sup>st</sup> Dist. 1988); Masini v. Department of Revenue, 60 Ill. App. 3<sup>rd</sup> 11, 15 (1978); Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 156-57 (1968). The taxpayer must present evidence that is consistent, probable, and identified with the taxpayer's books and records to support its claim. *Id.*

In the present case, the Department's *prima facie* case with respect to the taxpayer's status as a responsible officer was established when the Department's certified record relating to the Notice of Deficiency at issue was admitted into evidence. 35 ILCS 5/904(a); Balla, supra. In response, the taxpayer has presented testimony, but no documentary proof, that he did not have control over the payment of withholding taxes.<sup>4</sup>

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<sup>4</sup>While the Department introduced evidence showing that the company's Chief Executive Officer, Joe Blow rather than the taxpayer signed the company's Illinois Business Registration as the officer responsible for taxes, and signed the company's tax returns, the courts have held that there may be more than one responsible officer in a corporation. Monday v. U.S., 421 F. 2d 1210 (7<sup>th</sup> Cir. 1970), cert. den. 400 U.S. 821 (1970); Williams v. United States, 931 F. 2d 805, 810, n. 7 (11<sup>th</sup> Cir. 1991); Boding v. U.S., 565 F. 2d 663, 671 (Ct. Cl. 1977) ("[The statute] does not confine liability for unpaid taxes only to the single officer in the corporation with the greatest or the closest control over corporate affairs."). While the Department's documents show that Joe Blow had control over tax compliance, they do not preclude a conclusion that Doe also had control over this area.



Unfortunately, the taxpayer, who bears the burden of proof sufficient to rebut the Department's *prima facie* case, has submitted insufficient evidence to support his claim. As noted above, the taxpayer must present evidence supported by the taxpayer's books, records or other documents showing that the taxpayer did not have control over the payment of taxes. The only documentary evidence presented concerning the taxpayer's responsibilities during the tax period at issue is ABC's Illinois Business Registration, which shows that the taxpayer was the president of this corporation. Dept. Group Ex. 1 (Illinois Business Registration). Since the President ordinarily exercises control over all of the corporation's affairs, this documentary evidence does not support the taxpayer's contentions. Thus the only evidence supporting the taxpayer's claim that he was not responsible is the taxpayer's own testimony that he was not in control of the company's finances or tax preparation and filing. This evidence is insufficient to overcome the Department's *prima facie* case. Jefferson Ice Co., supra; Mel-Park Drugs, supra; A.R. Barnes & Co., supra; Masini, supra; Copilevitz, supra. To prove his claim, the taxpayer needed to present corroborating documentation such as corporate by-laws or the taxpayer's employment agreement delineating the duties and responsibilities vested in the president, or bank cards or other bank records showing that the taxpayer did not have the authority to direct the payment of bills during the tax period at issue. Without such evidence, it must be found that the taxpayer has not rebutted the Department's finding that he was a responsible officer of ABC during the period at issue. *Id.*

The same conclusion must be reached regarding the Department's finding that the taxpayer acted "willfully." The Department's certified record also established its *prima*

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*facie* case that the taxpayer acted with reckless disregard of obvious risks that taxes would not be paid (Wright, supra), i.e. “willfully.” 35 ILCS 5/904(a); Balla, supra. To support his claim that he did not act willfully, Doe relies on In Re Stoecker, 202 B.R. 429 (Bkr. N.D. Ill. 1996) for the proposition that only persons having the ability to exercise control over the company’s finances and taxes can be liable for willful failure to remit taxes.<sup>5</sup> In reaching this conclusion, the Bankruptcy Court states as follows:

The Court finds that IDOR’s NPL, together with the Debtor’s status as corporate officer, director, and shareholder does not establish that the Debtor exercised control over Chandler’s finances and payment of its taxes. Rather, the evidence leads the Court to conclude that he delegated such authority and power to Pluhar. Because there is no evidence before the Court to show that the Debtor had control, supervision, or responsibility for the payment of Chandler’s taxes, there can be no finding that the Debtor took any action that can be construed as voluntary, conscious, and intentional or in reckless disregard with respect to any failure to pay assessed taxes. (emphasis added). Stoecker, supra at 455.

Relying upon the foregoing, the taxpayer argues as follows: “(T)here **IS** evidence in the record which clearly shows that Doe did **NOT** have control, supervision or responsibility for the payment of ABC’s taxes ... [A]ccordingly, there can be no finding that Doe took any action that can be construed as voluntary, conscious and intentional or in reckless disregard with respect to any failure to pay assessed taxes.” Taxpayer’s Brief, p. 19. (emphasis in the original). However, as noted above, I find that there is insufficient evidence in the record to rebut the Department’s *prima facie* finding that Doe did have control, supervision or responsibility over the payment of ABC’s taxes. Accordingly, a

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<sup>5</sup> The Bankruptcy Court’s determination in favor of the taxpayer was reversed by the Appellate Court (179 F. 3d 546 (7<sup>th</sup> Cir. 1999)), and the Appellate Court’s determination was affirmed by the U.S. Supreme Court (530 U.S. 15 (2000)).

finding that Doe did not act willfully that is contingent upon a finding that he did not have such control cannot be sustained.

The gravamen of Doe's claim that he did not act willfully is his contention that he ceded the entire responsibility for tax compliance to Blow. Taxpayer's Brief, pp. 10, 11. Even if evidence in the record conclusively established this claim, the Illinois and federal courts have repeatedly held that responsible officers are liable for willfully failing to remit taxes if they delegate responsibilities but fail to inspect corporate records or otherwise fail to keep informed of the status of tax returns and payments. Branson, *supra* at 267; Thomsen v. United States, 887 F. 2d 12 (1<sup>st</sup> Cir. 1989); Dougherty v. United States, 18 Cl. Ct. 335 (1989). This is particularly true when an officer is aware that the corporation is experiencing financial difficulties or of other reasons creating a grave risk that taxes might not be paid. Wright, *supra*.

The record in this case reveals that Doe was completely aware of ABC's financial problems. Tr. pp. 29, 30, 49-54, 69. Indeed, he admitted that he was aware that Federal payroll taxes were not being paid, and participated in a conference with the IRS concerning similar compliance omissions alleged by the federal government. Tr. pp. 56, 57, 70, 71. However, there is no evidence that he ever attempted to see to it that any state tax compliance and payment responsibilities ceded to Blow were not compromised by the company's financial position and were being carried out. A responsible person cannot escape his obligation to ensure that taxes are paid simply by abdicating responsibility in favor of others in this manner. Smith v. United States, 894 F. 2d 1549, 1554 n. 5 (11<sup>th</sup> Cir. 1990); Wright, *supra* at 427 ("The word 'recklessness' in law covers a spectrum of meaning ... [.] ... (B)earing in mind that if a high degree of recklessness were required

the purpose of the statute would be thwarted, just by compartmentalizing responsibilities within a business (however small) and adopting a “hear no evil—see no evil” policy, we think gross negligence is enough to establish reckless disregard. Concretely we hold that the ‘responsible person’ is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily.”).

**WHEREFORE,** for the reasons stated above, it is my recommendation that the Department’s Notice of Deficiency number 0000 be finalized as issued.

Ted Sherrod  
Administrative Law Judge

Date: October 20, 2005